INDEX

	Page
Petition:	
Statement	2
Specification of errors	3
Reasons for granting the writ	3
Brief:	
Opinions below	4
Jurisdiction	4
Statement	6
Argument	6

CITATIONS

Cases:	
D'Oench, Appeal of Alice Grace, 3 B. T. A. 24	8
Madden, John J., Appeal of, 2 B. T. A. 702	8
McCaughn v. *Ludington*, 268 U. S. 106	3, 6, 8
Statutes, etc.:	
Revenue act of 1918, c. 18, sec. 214(a)(5), 40 Stat. 1057, 1066	5
Treasury Regulations No. 45, art. 141, promulgated April 17, 1919, and amended January 28, 1921	5, 6

In the Supreme Court of the United States

OCTOBER TERM, 1927

No. ——

D. B. HEINER, COLLECTOR OF UNITED STATES Internal Revenue for the Twenty-third District of Pennsylvania, petitioner

v.

JAMES R. TINDLE AND THE UNION TRUST COMPANY of Pittsburgh, Coexecutors of the Last Will and Testament of Philander C. Knox

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of D. B. Heiner, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on April 4, 1927 (R. 50), reversing the judgment of the District Court of the United States for the Western District of Pennsylvania (R. 43).

STATEMENT

The question presented is whether a loss incurred in a sale of residential property is deductible in computing a taxpayer's net income under the provisions of Section 214 (a) (5) of the Revenue Act of 1918.

In 1887 Philander C. Knox, the taxpayer, now deceased, built a residence in Pittsburgh at a cost of $172,000. The building was occupied by him as his residence until 1901, at which time he moved to the Schenley Hotel, Pittsburgh, where he resided until his death in 1921. From 1901 until 1920 the residence was leased to various tenants. There is no evidence as to the value of the property in 1901. In 1920 it was sold for $73,706.79. On March 1, 1913, the property was worth $120,000. In computing his 1920 income for income-tax purposes the taxpayer claimed as a loss the difference between the value of the residence on March 1, 1913, and its sale price in 1920. (R. 35–40.)

The petitioner contends that the purchase of the property by the taxpayer for his residence in 1887 was not a transaction entered into for profit under Sectiton 214 (a) (5) of the Revenue Act of 1918, and that the leasing of such residence property in 1901 did not initiate a new transaction under the statute.

The District Court for the Western District of Pennsylvania decided the case in favor of this petitioner. (17 F. (2d) 522.) The judgment of the Dis-

trict Court was reversed by the Circuit Court of Appeals for the Third Circuit. (18 F. (2d) 452.) The Circuit Court of Appeals entered judgment on April 4, 1927, and it is to review this judgment of the Circuit Court of Appeals that the writ of certiorari is now sought.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals, Third Circuit, erred:

I. In reversing the judgment of the District Court of the United States for the Western District of Pennsylvania.

II. In holding that the transaction which resulted in a loss by the sale of the taxpayer's property was entered into for profit.

III. In holding that the transaction which resulted in a loss by the sale of the property was entered into by the leasing of the property.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals has misconstrued Section 214 (a) (5) of the Revenue Act of 1918 in holding that a loss sustained upon the sale of a residence property is deductible in computing taxable income.

2. The decision of the Circuit Court of Appeals is contrary to the decision of this Court in *McCaughn* v. *Ludington* (268 U. S. 106), in which it was held that a deductible loss must be measured by the difference between the selling price and the cost or the March 1, 1913, value, whichever is lower.

3. A proper construction of Section 214 (a) (5) of the Revenue Act of 1918 is fundamental in auditing many thousands of income-tax returns because said section was intended by Congress to fix the dividing line between business transactions entered into for profit and personal transactions.

4. The decision of the Circuit Court of Appeals changes the long-established and accepted practice of the Treasury Department and the basis generally adopted by taxpayers in filing returns.

5. The decision of the Circuit Court of Appeals is contrary to the rulings of the United States Board of Tax Appeals.

Wherefore, it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

JUNE, 1927.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the District Court (R. 29) is reported in 17 F. (2d) 522. The opinion of the Circuit Court of Appeals (R. 48) is reported in 18 F. (2d) 452.

JURISDICTION

The judgment of the Circuit Court of Appeals sought to be reversed was entered April 4, 1927. (R. 50.) Jurisdiction to issue the writ is found in

the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question presented is whether Section 214 (a) (5) of the Revenue Act of 1918, providing a deduction in computing net income for losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business, contemplates a deduction for loss resulting from the sale of residential property purchased, erected, and used as a residence for the taxpayer, and which is later, before sale, leased and occupied by tenants.

THE STATUTE

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1066, provides as follows:

> SEC. 214 (a). That in computing net income there shall be allowed as deductions * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

Regulations 45, as promulgated April 17, 1919, provide as follows:

> ART. 141. *Losses.*—* * * A loss in the sale of an individual's residence is not deductible.

This was amended on January 28, 1921, and thereafter reads as follows:

> ART. 141. *Losses.*—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

This provision is also contained, unchanged, in Regulations 62 under the Revenue Act of 1921, Regulations 65 under the Revenue Act of 1924, and Regulations 69 under the Revenue Act of 1926.

STATEMENT

The facts are sufficiently stated in the petition for certiorari.

ARGUMENT

The Circuit Court of Appeals concedes that the acquisition of the property by the taxpayer for a residence in 1887 was not a transaction entered into for profit. The gist of its decision is that since the property was leased to others for use as a residence from 1901 until the sale thereof in 1920 a new transaction commenced, which was entered into for profit.

In this case the property cost $172,000 in 1887. It is undisputed that the property was worth $120,000 on March 1, 1913, and that it was sold in 1920 for $73,706.79. The loss resulting from the sale of the property, under the decision of this Court in *McCaughn* v. *Ludington* (268 U. S. 106), if deductible, would be the difference between the

the selling price and the cost or March 1, 1913, value, whichever is lower. In determining the amount of such loss in this and in all other cases the original cost is a factor. There is nothing in the law to warrant the use of the value as of the date when a property, acquired and used as a private residence, is leased to others for residential purposes. Furthermore, in this case there is no evidence of the value of the property as of the date when it was leased in 1901.

The loss which the taxpayer sought to deduct is the loss which occurred when the property was sold for less than it cost. Manifestly, the "transaction" which was *ended* by the *sale* must have been *begun* by the *purchase* of the same property, since the purchase price is a factor in determining loss or gain. It necessarily follows that the "transaction" resulting in the loss was "entered into" by the purchase. That transaction concededly not having been entered into for profit, it follows as of course that no loss resulting from that transaction is deductible.

The Circuit Court of Appeals held that the leasing of the residence in 1901 was the beginning of a new transaction. To be consistent, the cost of acquisition at an earlier date could not be used as a basis for determining gain or loss, because on date of acquisition and for years afterwards the property was intended and used for personal residence of the owner. No cost or value as of 1901,

when abandoned as the owner's residence, is disclosed by the record, and without it the rule in the case of *McCaughn* v. *Ludington, supra,* can not be applied.

If the leasing of the property was a new transaction, that transaction was not ended by the sale of the property. The taxpayer sold the residence, not the lease; hence it follows that the leasing transaction was not ended by the sale nor was it the transaction out of which the loss occurred. If the execution of the lease was the beginning of the transaction, then that transaction could only end by the expiration of the lease or by the sale thereof. Hence a deductible loss could flow only from that transaction. The purchase and sale of the real estate is entirely disconnected from such a loss.

A proper construction of Section 214 (a) (5) of the Revenue Act of 1918 is extremely important to the Government and to taxpayers generally. That provision has been reenacted by Congress without change in the three succeeding Revenue Acts of 1921, 1924, and 1926. The Regulations of the Treasury Department have consistently interpreted the law as contended for by the petitioner in this case. The United States Board of Tax Appeals has followed the Department's interpretation of the law in similar cases. (*Appeal of John J. Madden,* 2 B. T. A. 702; *Appeal of Alice Grace D'Oench,* 3 B. T. A. 24.)

This particular section of the law embodies the dividing line between losses resulting from business

transactions entered into for profit and purely personal transactions. Unless the provision in the statute that gain or loss may be considered only if in transactions *entered into* for profit be literally applied the greatest confusion results. The decision of the Circuit Court of Appeals introduces an element of confusion and uncertainty as to what is meant by a transaction entered into for profit. If the decision of the Circuit Court of Appeals is allowed to stand unreversed, a large amount of litigation will result and large sums of money will be required to be refunded. In view of this and of the need for a definite rule for the guidance of the courts and the Treasury Department in such cases, it is respectfully submitted that the petition for certiorari should be granted in this case.

Respectfully submitted.

WILLIAM D. MITCHELL,
Solicitor General.
F. S. TOOMEY,
Special Attorney,
Bureau of Internal Revenue.

JUNE, 1927.

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